As I see

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THE FUTURE OF RESIDENTIAL RENTS

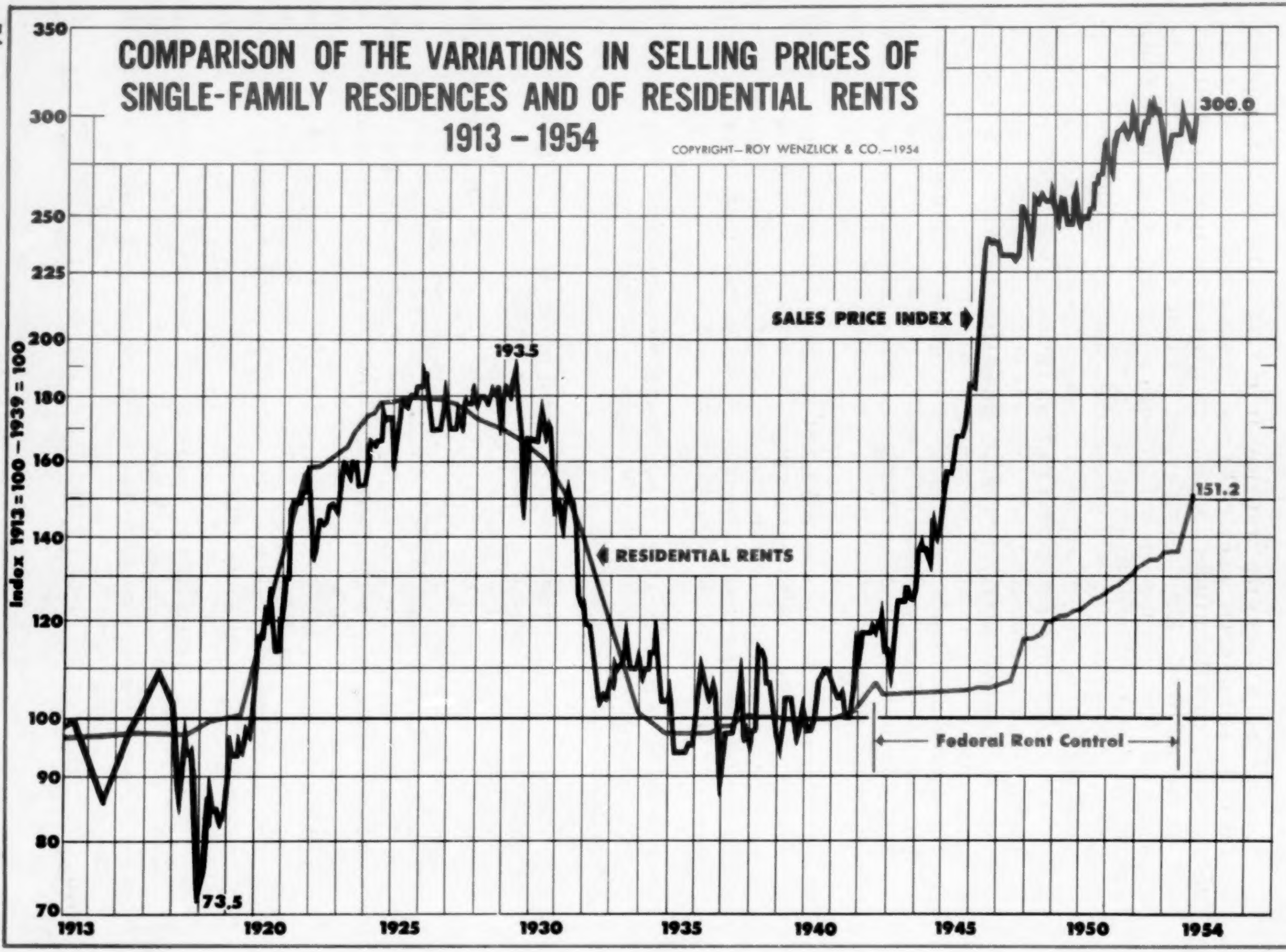
IF a sizable economic readjustment takes place in the economy, what will happen to residential rent levels in a city free of rent control? This question is of fundamental importance to the real estate owner, the mortgage lender, and the appraiser.

The posing of this question is not a forecast that a sizable economic readjustment will take place. We are all hopeful that proper Federal Reserve policies may mitigate the adjustment which has now started, and prevent it from feeding on itself and becoming a major depression. At the present time, however, no one knows how far a downward trend may carry us.

It seems to me that while we hope that the readjustment will be mild, we should so manage our affairs that we will be in the best possible position should the downward trend accelerate.

The chart on the following page shows the relationship of the selling price of single-family residences to residential rents for the period from 1913 to 1954. The broad similarity of the fluctuations in the rent index and the selling price index in the period prior to 1942 is quite striking, as is the dissimilarity in the two lines for the period from 1942 to the present. It will be remembered that Federal rent control went into effect in 1942, and was continued until the latter part of 1953. If Federal rent control was the primary cause of the divergence of the two lines, we would normally expect that its termination would cause the two lines to move toward each other again until the old relationship was re-established. This could come about in one of three ways: 1. the rent index could move up to the selling price index; 2. the selling price index could drop to the level of the rent index; and 3. the selling price index could move down and the rent index could move up.

If the two lines come back into adjustment in the next 4 or 5 years, it seems to me that the third alternative is the most probable - that is, that the selling price index will move down part way and the rent index will move up until the two are again in rough agreement.



COMPARISON OF THE VARIATIONS IN SELLING PRICES OF SINGLE-FAMILY RESIDENCES AND OF RESIDENTIAL RENTS
1913 – 1954

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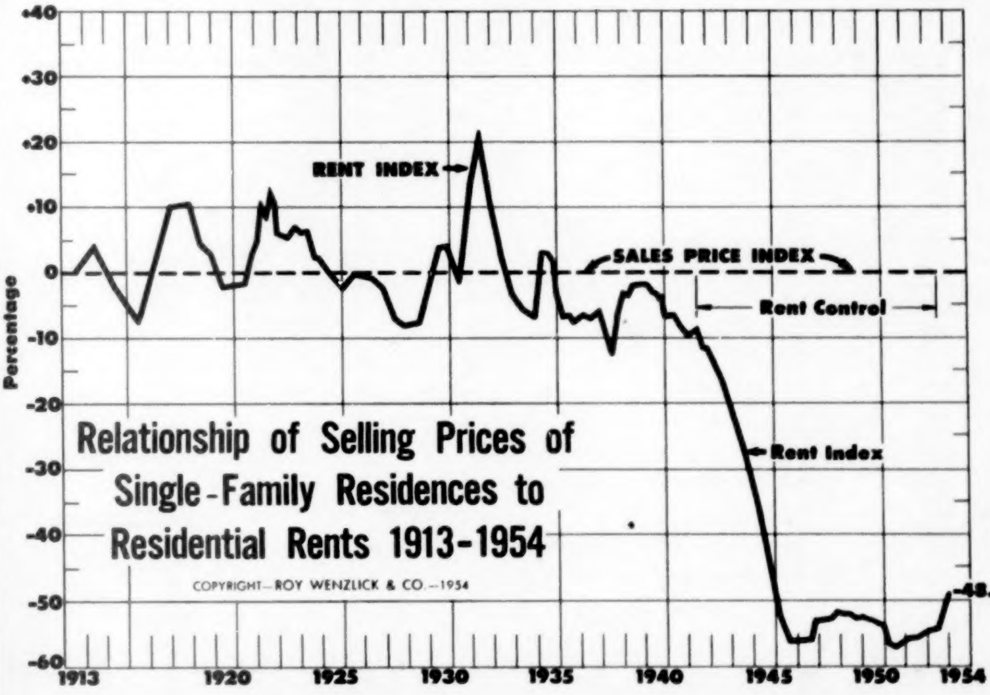
The chart below shows the rent index from 1913 to the present as a percentage of the selling price index. The resulting line has been smoothed, as the month-to-month fluctuations are not of primary importance in comparison with the general trend. It will be noticed on this chart that if the old relationships still hold true, residential rents are only about half as high as we would expect from the level of selling prices.

If your interest is in a city which was fortunate enough to get out from under Federal rent control before the rest of the United States, it may be that rents are in a slightly better relationship to selling prices of houses than this chart would indicate. In Houston, Texas, for instance, rents were decontrolled in October 1949, and rents are now about 65% as high as we would normally expect from the pre-rent-control relationship of rents to selling prices of single-family residences. In Birmingham, Alabama (decontrolled in May 1950), and in Detroit, Michigan (decontrolled in September 1952), the percentage relationship of rents to selling prices is slightly higher than it is in Houston.

Many things may happen in the near future which would delay the snapping back to the old relationship. Large unemployment, with a drop in purchasing power, would shrink demand for both rental units and for the purchase of single-family residences. At the same time it would increase the number of places offered for



sale and probably, too, the number of units offered for rent. This would tend to accelerate the downward movement of both lines.

Easier sales terms with lower down payments, if these should develop as a part of the President's program, would tend to inflate selling prices and, everything else being equal, to depress rents, as it would swing some demand from the rental to the sales field. One limiting factor on rent levels is the monthly cost of ownership of dwelling units if down payments are nominal. The average family will not pay more in rent per month than its payments, taxes and upkeep would run if the property were owned. This means that over the long period, lower interest rates and longer periods of amortization would result in lower rentals.

In spite of all of the various factors which might develop, it is my opinion that in 5 years or so residential rents and the selling prices of single-family residences will again be close to the relationship which was maintained prior to the period of Federal rent controls.

If this does not develop, it means that it would be better to sell a residence than to rent it, and it also means that rent levels would not be high enough to stimulate new construction for rent. Both of these factors would tend to limit additions to the supply of rental housing. This in itself would tend to continue the housing shortage, with increases in rents, and would probably, in a slightly longer time, restore the old relationships of the two lines on our charts.

In other words, for the long pull it seems to me that the level of rents is still relatively low.

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